United States Court of Appeals

for the Second Circuit

APPELLANT'S BRIEF

76-7520

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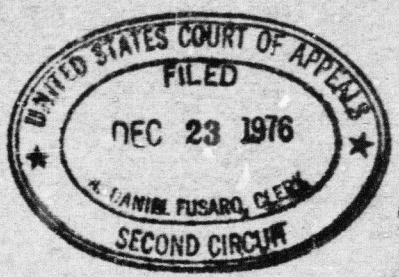
DOCKET NO. 76-7520



MERLE W. LEONARD,

Plaintiff-Appellant,

v

REYNOLDS SECURITIES, INCORPORATED, J.C. BRADFORD & COMPANY, VOGEL LORBER, INCORPORATED, JOSEPH EZRA & COMPANY, INCORPORATED, GOLDNICK & SON, INCORPORATED and SAMUEL GOMBERG,

Defendants-Appellees.

On Appeal from the United States District Court
for the Southern District of New York

APPELLANT'S BRIEF

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APPELLANT'S BRIEF

In this class action to recover damages on behalf of purchasers of securities sold without registration under Section 5 of the Securities Act of 1933 (the "Act") plaintiff appeals from an order of the District Court for the Southern District of New York, Pierce, J., denying plaintiff's motion for class action determination. The decision below (A270) is not reported.

QUESTION PRESENTED

Should this case proceed as a class action?

JURISDICTION

The order below was entered August 19, 1976. The notice of appeal was filed September 14,1976. This Court's jurisdiction rests on 26 U.S.C. § 1291. The order below is final under 28 U.S.C. § 1291 under this Court's death knell doctrine, because plaintiff's damages are so little, i.e., $278.75 (A182) that this "suit would end if class action status were denied." Jelfo v. Hickock Mfg. Co. Inc., 531 F.2d 680, 681 (2nd Cir. 1976).

The district court's jurisdiction rested on Section 22 of the Act.

STATEMENT OF THE CASE

This is a class action to recover damages under Section 12(1) of the Act on behalf of all persons who purchased unregistered call options from defendants during the class period. The defendants are securities brokers (A 27-29). Call options are securities under Section 2(1) of the Act. See Point III, infra. The options themselves are securities quite apart from the underlying stock into which they are

exercisable, and the theory of this case is that they may not be sold without registration under Section 5 of the Act. Today, however, call options are registered under Section 5 of the Act, and they are listed for trading by five registered national securities exchanges. Section 12(1) of the Act provides a remedy of damages to a purchaser of unregistered securities. Two defendants admit and one denies that during the class period they sold call options, none of which were registered under the Act. (A 35, A 41, A 48).

The class period begins November 29, 1971 and ends November 29, 1971 were barred from recovery under § 12(1) of the Act under the one year statute of limitations of § 13 of the Act.

The Sale of Call Options*

A call option (also known as a "call" or an "option")

* The following discussion concerns sales of call options as they were handled during the class period, not as they have been since the commencement of trading on exchanges.

is a written option contract giving the purchaser thereof the right to buy a stated number of shares of a designated stock at a stated price per share (which is adjustable for dividends, splits, etc.) for a fixed time (A 181-183). A standard blank printed form of written option contract is used and filled in for each new option. This form is not given to the purchaser, whose only evidence of ownership is his confirmation and monthly statement furnished by a broker.

The writer is the person who grants or creates the call option (A 181). Plaintiff contends that the writer is the issuer of the option as the term "issuer" is defined under Section 2(4) of the Act. The writer receives a consideration known as a premium in exchange for and at the time of writing the option. Should the option subsequently be exercised, he receives the agreed upon price in exchange for the underlying stock.

During the class period, call options were purchased and sold over the counter. In this case, the writer was a client of defendant Reynolds Securities, Inc. which is a large securities broker with an

extensive retail business. The plaintiff purchased the call option from defendant J.C. Bradford & Co., a large securities broker with an extensive retail business. The writer's broker sold the call option to the purchaser with the assistance and participation of J.C. Bradford and defendant Vogel-Lorber, Inc., a securities broker whose business was primarily limited to dealing in options (A 189).

The writer's broker endorsed or guaranteed performance of the writer's obligations under the call option and received a fee therefor. The writer's broker issued a guarantee of the option within the meaning of Section 2(1) of the Act.

During the class period these three defendant brokers sold a large volume of call options to members of the public. The sales took place either in the way in which the instant sale occurred,, or, if any of the defendants, acting as the writer's broker, could find a purchaser among its own clientele, the sale was made without the intercession of the other two brokers.

Despite the fact that during the class period defendant brokers were actively engaged in distributing a large volume of call options to the public, none of

the options were registered under the Act. However, on April 26,1973, shortly after this action was begun, the Chicago Board Options Exchange began to list options for trading purposes. Today, options are listed for trading by four other national securities exchanges, i.e., the American, Philadelphia, Pacific and Midwest stock exchanges. Trading in listed options constitutes substantially all the trading in options such as plaintiff bought. Registration statements under Section 5 of the Act are in effect as to all listed options.

The Issues

The question presented in this case is whether this action should proceed as a class action on behalf of all purchasers of call options. The only substantive objection raised by defendants is that such a class, if formed, should consist only of purchasers of calls on the same underlying stock as that in plaintiff's call option (A 169). Unfortunately, the district court has never addressed this question. Instead, the district court denied class action status solely upon the asserted but erroneous ground that plaintiff or his counsel have delayed this case unduly (A 270).

It is indeed true that this case has suffered from undue delay. However, the only significant delay that has affected this case has resulted from:

(a) the failure of the district court to decide plaintiff's class action motion, despite repeated requests that it do so; and

(b) the defendants' propounding of extremely improper interrogatories, which have engendered protracted argument.

In this case it is the procedural events which have created the issues bearing on the class action question. Those issues are:

(1) Did plaintiff delay this case unduly; did the district court abuse its discretion in delaying the determination of the class action question for three and one-half years and then denying the motion for what was at most a highly technical default of the plaintiff:

(2) Did defendants' propound objectionable interrogatories?

The Procedural Developments Giving Rise to the Issues in this Case

This action was commenced in the district court on November 29, 1972 by Merle W. Leonard, a resident of Decatur, Georgia (A I A26. A76).

On Monday, January 29, 1972, plaintiff moved by order to show cause for a short extension of his time to move for class action determination, seeking relief from the 60-day rule of Civil Rule 11A(c) of the Southern District Local Rules.* At or about that same time, defendants served interrogatories on plaintiff (and also served answers to the complaint as well) (A2). At the hearing on this show cause order, defendants requested that plaintiff not be permitted to make his class action motion until after he had responded responded to their outstanding interrogatories. Defendants claimed that they needed those responses in order to make an effective opposition to the class action motion. The Court ruled in defendants' favor.

*The reason plaintiff asked for this extension is that there was then pending a dispute as to who would serve as plaintiff's counsel. Plaintiff asked for ten days following court selection of counsel to move for class action determination.

A series of orders were entered which extended plaintiff's time to respond and delayed the date when he might move for class action determination (A4-7). Plaintiff served answers and objections to defendants' interrogatories on May 4, 1973 (A 73). Plaintiff appeared in New York for his deposition in this case on May 10, 1973.

In June 1973, plaintiff made his class action motion and served a set of interrogatories (A 51). The Court extended defendants' time to respond to the interrogatories to September 3, 1973 (A7-8). However, no adjournment of the class action motion was sought or ordered, nor did defendants ever respond thereto. Moreover, the court never decided that motion although plaintiff repeatedly requested a decision.

Instead, on or about September 4, 1973, many of the defendants (but not the three defendants-appellees) made a motion for summary judgment (A8). Originally, the defendant herein were those securities brokers who dominated the market for trading in options and Bradford, the broker who sold plaintiff his call option. The dominant brokers included four large retail brokers and nineteen option dealers, i.e. securities brokers whose business was primarily limited to transactions in options. Plaintiff sought to represent a class of call option

purchasers who had bought from any of the defendants irrespective of whether plaintiff himself has had any dealings with them. As stated, supra, p. 4-5 plaintiff bought his call option from three of the defendants, Reynolds, Vogel-Lorber and Bradford.

All the other defendants then made a motion for summary judgment. They contended that the privity requirement of § 12(1) of the Act precluded plaintiff from suing them even in a representative capacity. The district court granted the motion, and the opinion is reported as Leonard v. Merrill, Lynch, Pierce, Fenner & Smith, Inc., 64 F.R.D. 432 (SDNY 1974). Plaintiff did not appeal from that judgment.

During the thirteen months that the summary judgment motion was pending, the court ignored the repeated entreaties of plaintiff to decide the class action motion. Plaintiff argued that even if it were better for the court to decide the summary judgment motion first, it was perfectly obvious that three of the defendants were not moving for judgment and that as to them the class action motion was ripe for disposition. Plaintiff first advanced this argument on November 9, 1973 in the affidavit and brief in opposition to the summary judgment motion.

While the two motions were pending, in January 1974, defendants wrote a letter to the court calling its attention to the reversal by the Ninth Circuit of a case upon which plaintiff had relied. In responding to that letter, plaintiff, in a letter to the court dated January 22, 1974, once again asked the court to decide the class action motion with respect to non-moving defendants.

On March 29, 1974, the court entered an order requiring oral argument on the summary judgment motion to take place on April 11, 1974 (A 10). At the oral argument, plaintiff yet again requested the court to decide the class action motion.

The court decided the defendants' motion for summary judgment on or about September 30, 1974, but yet did nothing with respect to plaintiff's class action motion.

Shortly after the court granted summary judgment to the moving defendants, it referred this case to then Magistrate Goettel to supervise further pretrial procedures in this case (A 11).

Plaintiff requested of the Magistrate that the remaining defendants finally be required to answer or object to his interrogatories which were then sixteen months old. Pursuant to the Magistrate's schedule, on or about December 19, 1974, defendants served answers and

objections to plaintiff's interrogatories of June 12, 1973 (A 13). On December 26, 1974, plaintiff moved to compel disclosure of information concerning the writing of call options as to which defendants had objected in response to plaintiff's interrogatories (A 13). Plaintiff withdrew his motion upon defendants' agreement to furnish the information under a stipulation of confidentiality (A 15). Upon examination of these data, plaintiff was able to obtain evidence bearing upon the merits of this case.

As plaintiff was pressing forward before the Magistrate, defendants abruptly decided that they needed to serve a second set of interrogatories. Defendants claimed that the second set of interrogatories was necessary in aid of their opposition to plaintiff's pending class action motion. They argued that prior discovery had yielded meager results. They served the second set of interrogatories on January 2, 1975, approximately eighteen months after plaintiff had appeared at a deposition and answered interrogatories (A 93).

Why defendants took approximately sixteen months to conclude the plaintiff had not supplied them with enough information to formulate a response to the class action motion is unknown. However, the effect on the progress of this lawsuit of defendants' newfound need for

discovery is no mystery. The interrogatories propounded by defendants in their second set were so long, so irrelevant and so provocative as to guarantee a long delay before the court would come to grips with the class action motion.

Defendants' second set of interrogatories (A 93) had hardly any relevance to the class action motion. They consisted of 48 numbered questions nearly half of which had numerous parts and subparts. Of these only interrogatories 23, 29 through 36 and possibly 45, all of which for the most part asked for legal conclusions, had a prima facie legitimate bearing on the class issues. Interrogatories 10 through 14 dealt with communications between plaintiff and other class members (there were none). Interrogatories 1 through 9 and 22 and 28 dealt with the merits. Interrogatories 38 through 47 dealt with whether plaintiff had ever been involved in any other litigation.

However, the most offensive interrogatories of all were 15 through 21 and 24 through 27. These questions sought to inquire of plaintiff's financial condition and his willingness to bear the costs of this case. They also inquired into the nature of his retainer agreement with counsel and the circumstances of his decision to start this case (A 93).

After carefully considering defendants' interrogatories, plaintiff decided to object to answering a number of the questions including all those questions seeking details of his financial condition, his willingness to commit his treasure to the prosecution of this case, and his arrangement with his counsel (A 125). Plaintiff contended then as he did on his deposition - eighteen months before, as he does now, that such questions bear no relevance to the standards of Rule 23.

Upon receiving plaintiff's objections, defendants moved before Magistrate Goettel under Rule 37 for sanctions. Magistrate Goettel recommended largely overruling plaintiff's objections despite persuasive authority to the contrary. Sanderson v. Winner, 507 F.2d 477 (10th Cir. 1974) cert. den. 421 U.S. 914 (1975), and despite the impact of "conflicting policies" (A-175) bearing on the question.

Although the Magistrate recommended that plaintiff be required to answer these questions (save to the extent that the attorney-client privilege not be invaded) he suggested a painless method of resolving the controversy. To understand his suggestion, it is necessary first to see, as did the Magistrate, that "class composition is still an issue." (A 174). The question is whether the class is

composed of all purchasers of call options during the class period or whether the class must be limited solely to those persons who bought call options on the same underlying stock (Cooper Tire) that plaintiff did. Thus, Magistrate Goettel suggested (A 175):

> "[C]ooperation among the attorneys can act to avoid collision of interests at this time. If absolutely necessary, the motion could be taken in two steps: the first to determine class composition and, therefore, size, and the second,if the court approves a large class, concerned with financial ability."

Magistrate Goettel made a supremely sound suggestion, because if the class were limited to calls on Cooper Tire the class would be too small to satisfy the numerosity requirement of Rule 23(a)(1). Judge Pierce confirmed the Magistrate's report on or about September 23,1975 (A 178).

In response to Magistrate Goettel's decision, plaintiff quickly made a motion for class action determination and summary judgment (A 179).* In his motion papers, he asked the court to defer the time for answering interrogatories until after the size and composition

*For their mutual convenience, the parties adjourned the return day of this motion 4-1/2 months. Defendants contended that no response to the motion was due until plaintiff answered the interrogatories. Plaintiff took the view that his motion was in conformity with the court's two step suggestion as framed by Magistrate Goettel. He also took the view that he could by his motion properly ask the court to modify its order. At the same time, plaintiff was contemplating seeking a writ of mandamus in this court. When the district court finally declined to grant further extensions plaintiff decided to go forward on the motion rather than seek mandamus.

of the class could be determined. Judge Pierce responded to plaintiff's motion with a scathing denunciation of his counsel, castigating them as the supposed cause of all delay in this case and, adding insult to injury, asserting that plaintiff had never even asked the court to modify its earlier Rule 23 order. The court then denied the second class action motion. However, the denial was without prejudice to renewal of the motion within seven days upon a showing of plaintiff had filed full and complete answers to the class interrogatories. (A 221).

Plaintiff immediately sought to appeal from that order by a writ of mandamus in this court and also an extension from the district court (A (272). Both courts denied the relief sought (A 235, A 22). Accordingly, on the seventh day, plaintiff filed answers to the interrogatories (A 257, A269). However, through oversight and misunderstanding, he neglected to formally renew his motion for class action determination until August 5, 1976 (A 266). The court, on August 19, 1976, denied the motion with no more than a reference to its June 22 order (A 270).

This appeal is from the August 19, 1976 order.

POINT I

PLAINTIFF HAS NOT UNDULY DELAYED THIS CASE, RATHER THE DISTRICT COURT ABUSED ITS DISCRETION BY ITS DELAY AND DENIAL OF CLASS ACTION STATUS

The district court grossly abused its discretion in this case and failed to follow the rules with respect to its duty to make a timely disposition of plaintiff's class action motion. Rule 23(c)(1) of the Federal Rules of Civil Procedure commands the district court to decide a class action motion. Rule 23(c)(1) of the Federal Rules of Civil Procedure commands the district court to decide a class action motion "as soon as practicable." In furtherance of that command the district court's own Civil Rule 11A(c) requires plaintiff to make a class action motion within 60 days after commencement of the action. In short, on a class action motion, in the words of Judge Gurfein, "[s]peed is of the essence." Professional Adjustment Systems of America v. General Adjustment Bureau, Inc., 64 F.R.D. 35, 38 (S.D.N.Y. 1974).

Early in this case, when the 60 day limit on the time to move for class action determination was about to expire, and there was a pending dispute as to who was to be plaintiff's counsel, plaintiff asked for

a short adjournment until resolution of that dispute. Rather than grant a short adjournment, the district court, at defendants' request, actually forbade plaintiff from making his class action motion until he responded to plaintiff's discovery. When defendants had completed their discovery, plaintiff made his class action motion. Nevertheless, the district court never decided it despite repeated requests from plaintiff for a decision. Instead, the district court allowed defendants to commence yet another round of discovery some eighteen months after completion of the first round. It finally decided the class action motion more than three and one-half years after plaintiff attempted to make it.

The district court should have decided the class action much sooner than it did. When the class action motion was made, there was no defendants' request for discovery outstanding. As to the non-moving defendants, there was no basis for delay. With respect to the need for going forward on a class action motion, this court said, in Parkinson v. April Industries, Inc., 520 F.2d 650, 655 N. 4 (2nd Cir. 1975):

"[A]lthough the district court may postpone decision of the motion pending discovery the emphasis is on early determination. Wolfson v. Solomon, 54 F.R.D. 584 (S.D.N.Y. 1972). See also, Berland v. Mack, 48 F.R.D. 121 (S.D.N.Y. 1969)."

In Wolfson v. Solomon, supra, 54 F.R.D. at 590 cited by this Court in Parkinson, Judge Gurfein said:

"The emphasis is clearly on an early determination of whether the action is properly a class action,'and if so, the membership of the class.' It is true that the Court 'may order postponement of the determination pending discovery' etc., and the thrust of the Rule is that unless such postponement is ordered, the motion is for a 'determination' and should be decided promptly. The same emphasis on an early determination as specified in our Court Rule, exists under Rule 23 itself. Frankel, Some Preliminary Observations Concerning Civil Rule 23, 43 F.R.D. 39, 40-42 (1967); Advisory Comm. Notes to Rule 22, 39 F.R.D. 104 (1966)."

By late 1974 the district court should have taken up the long pending class action motion. It should never have allowed defendants to start new discovery when the case was over two years old, and they had done no discovery for sixteen months. A similar situation existed in Berland v. Mack, supra, 48 F.R.D. at 126, also cited by this court in Parkinson, supra, where plaintiff had requested a delay of class action by the Securities and Exchange Commission. The delay was for more than two years. When the S.E.C. action ended plaintiffs asked for an additional delay in order to conduct class action discovery. Judge Mansfield

ruled that F.R. Civ. P.Rule 23(c)(1) prohibited further delay at that time and went forward to decide the class action motion.

The inaction of the district court could not have been more opposed to the requirements of F.R. Civ.P. Rule 23 (c)(1) and its own Civil Rule 11A(c) -- a rule which "represents an important statement of policy which must be adhered to in the interests of justice." Sheridan v. Liquor Salesmen's Union, 60 F.R.D. 48, 51 (S.D.N.Y. 1973). So strong is this policy for prompt determination that if the parties themselves fail to raise the issue, "the Court, on its own, should proceed at an appropriate occasion to review the proposed class." Jeffrey v. Malcolm, 353 F.Supp. 395, 396 (S.D.N.Y.1973).

The second set of defendants' interrogatories touched on such sensitive issues that another long delay was inevitable. (The propriety of these interrogatories is contested in Point II, infra , of this brief). Plaintiff sought every available means to avoid answering them. Thus, when Magistrate Goettel recommended that the court order answers, plaintiff sought modification of that order in accordance with the suggestion (supra,p.15) that class composition be determined first. When the court declined to follow its own suggestion and ordered answers, plaintiff substantially complied by filing answers with the court. Sadly through misapprehension,

born of haste to satisfy the district court's order counsel believed the order called for a period of time during which defendants might object to the answers before renewal of the class action motion. Accordingly, after five and one half weeks in which plaintiff received no objection, plaintiff renewed his class action motion. plaintiff renewed his class action motion.

Surely, such minor neglect must not be viewed as rigid grounds for denial of class action status. Sanders v. Lum's Inc., '75-'76 CCH Fed. Sec. L.Rep. ¶ 95,536 (S.D.N.Y. 1976) (class action motion granted although made six years after commencement of action); Cf. Zients v. LaMorte, 459 F.2d 628 (2nd Cir. 1972). Surely, the district court should not be so inflexible, particularly when defendants' conduct and the court's own inaction are responsible for much greater delay. The statement of the court in Foxboro Co. v. Fischer & Porter Co., 29 F.R.D. 522, 523 (E.D. Pa.1961) is particularly appropriate here:

> "Having instigated the delay, defendant should not be permitted to profit from it by having the court grant its motion to dismiss."

Plaintiff did not dot every i and cross every t in conforming to the demands of the district court, but he was not the cause of the major delay in this case. The time causes of delay here were the district court's failure to turn to its duty to make an "early" class action determination and the district court's indulgence of defendants' unnecessary, untimely and protracted discovery which was provocative to an extreme degree. In such circumstances plaintiff respectfully submits that the fault must not be cast upon him.

POINT II

THE DISTRICT COURT ERRED IN ALLOWING DISCOVERY WITH RESPECT TO PLAINTIFF'S FINANCIAL CONDITION, HIS WILLINGNESS TO BEAR COSTS AND HIS ARRANGEMENTS WITH COUNSEL

A serious cause of substantial delay in this case was the dispute concerning defendants' interrogatories as to plaintiff's finances and his arrangements with counsel. Resolution of this dispute in defendants' favor not only served to increase the delay, but such resolution itself was in error. Courts, including this court, have roundly condemned the practice of

harassing and intimidating class action plaintiffs by means of totally needless discovery. Surowitz v. Hilton Hotels Corp., 383 U.S. 363 (1966); Sanderson v. Winner, supra; Korn v. Franchard, 456 F.2d 1206 (2nd Cir.1972). While there is some divergence of authority (even in the district court below) most courts recognize the mischief in allowing discovery of plaintiff's financial means. That mischief is the discouragement of class actions, and most courts have refused such inquiry. Thus, in Bogosian v. Gulf Oil Corp., 337 F.Supp. 1228, 1230 (E.D.Pa.1971) the court said:

> "Another group of questions to which movant seeks to compel answers deals with plaintiff's net worth and his ability to satisfy a judgment for costs in the event that defendants prevail in this action. These questions also are not proper since they are not relevant to the subject matter of the lawsuit."

The Tenth Circuit in Sanderson v. Winner, supra, 507 F.2d at 479-80, considered the matter in detail and said:

> "Defendants considered it important to ascertain whether plaintiffs were able to pay all of the costs in the litigation including extensive depositions. We fail to see relevancy in these inquiries particularly with respect to in limine inquiry as to whether a class action is to be allowed. Ordinarily Courts do not inquire into the financial responsibility of litigants. We generally eschew the question whether litigants are rich or poor. Instead,

we address ourselves to the merits of the litigation. [Footnote omitted]. We recognize that the class action is unique and we see the necessity for the Court to be satisfied that the plaintiff or plaintiffs can pay the notice costs, and we also agree fully with the Court's ruling in Eisen that due process requires decent notice. But we do not read Eisen as creating a presumption against finding a class action. Nor does it approve oppressive discovery as a means of discouraging a private antitrust action which, if meritorious, advances an important interest of the government.

We are aware that some lower Court decisions have considered the plaintiff's ability to pay as relevant and proper in the present context. See P.D.Q.Inc. of Miami v. Nissen Motor Corp. in U.S.A., 61 F.R.D. 372 (S.D. Fla. 1973); Ralston v. Volkswagenwerk, A.G., 61 F.R.D. 427 (W.D.No.1973).4 However, in both of these cases in which antitrust violations were alleged, the plaintiffs sought to represent a class of all new car purchasers in the United States. Thus, there was legitimate concern about the ability of the plaintiffs to successfully lead a class of this magnitude. Also, the Court in Ralston was concerned about its ability to manage the class. The mentioned considerations are not present here.

Nor do we see that the defendants have any legitimate concern as to whether plaintiffs will be able to pay their lawyers and will be able to pay a judgment for costs in the event that such a judgment is entered. In this respect we see no difference between the case at bar and any other lawsuit. Defendant will have ample opportunity for discovery under Rule 69 F.R.Civ.P. if it obtains

judgment. See Federal Savings & Loan Insur. Corp. v. Krueger, 55 F.R.D. 512 (N.D. Ill.1972); Gangemi v. Moor, 268 F.Supp. 19 (D.Del.1967). (Both cases suggest that there is no right to discovery of assets until judgment is obtained).

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4. But see to the contrary Sayre v. Abraham Lincoln Savings & Loan Ass'n.,65 F.R.D. 379 (E.D.Pa. 1974), holding that such probing is irrelevant. The Court considered both the ethics and inadequate representation problems in ruling on discovery similar to that sought."

Detailed inquiry into plaintiff's financial resources and his seal was also not allowed in Rosenberg v. Aktiebologet Electrolux, 74 Civ 3457 (CES) (SDNY 1975) (confirming opinion of Magistrate Raby which appears beginning A237) and In re Nissan Motor Corporation Antitrust Litigation. MDL 120 (S.D. Fla. June 4, 1975, Atkins, J.) A245 et seq.

As the Tenth Circuit noted in Sanderson v. Winner, supra, in those cases where courts have allowed inquiry into plaintiff's financial means, the court was faced with such an exceptionally large class that there was a genuine danger that plaintiff could not afford to give notice. Ralston v. Volkswagenwerk, A.G., 61 F.R.D. 427 (W.D. Mo. 1973) (a class of "as many as 4.5 million persons," 61 F.R.D. at 429); P.D.Q.Inc. v. Nissan Motor Corp., 61 F.R.D. 372 (S.D. Fla. 1973) cost of notice estimated at $300,000, 61 F.R.D. at 377).

In the instant case plaintiff faces no such difficulty. Plaintiff's discovery of defendants

indicates a class consisting of approximately 7,500 members. The defendants have records of every class member. It is impossible to conceive that the cost of notice could exceed $1,000, an amount which plaintiff could certainly afford.

In a similar situation in the district court below, Judge Owen in Friedlander v. City of New York, 75 Civ. 3981 (RO) refused even to allow such discovery of four plaintiffs when the class was estimated to consist of approximately 30,000 persons. (oral order of February 26, 1976).

The district court, in allowing defendants to inquire into plaintiff's means and zeal to protect this class has set a goat to guard the cabbages. Under the guise of protecting the class from an imperfect champion, the court destroyed its chances to recover.

POINT III

THIS ACTION SHOULD PROCEED AS A CLASS ACTION

The determination that an action proceed as a class action requires satisfaction of the four requirements of F.R. Civ. P. Rule 23(a). In addition the case must satisfy one of the three requirements of Rule 23(b); plaintiff relies on the third requirement - Rule 23(b)(3). This case easily satisfies the requirements of the rule. Those requirements are dealt with herein, and for clarity we will begin with a discussion of the existence of common questions of law and fact (Rule 23(a)(2)) and the predominance of such common questions (Rule 23(b)(3)).

A. Common Questions of Law and Fact Exist and Predominate in This Case

The common questions are (1) whether call options are securities within the meaning of the Act and (2) whether defendants' sale of call options to approximately 7,500 persons during the one year class period required that those call options be registered under the Act.

The question whether call options are securities affects every purchaser thereof in precisely the same

way. If, upon the merits, call options are held not to be securities, no class member has a claim. However, if they are securities, a necessary element of the class members' claims is established as to them all.

It is hardly open to debate that call options are securities. The relevant portion of the definitorial provision of §2(1) of the Act defines a security as:

> "any...stock...investment contract... or, in general, any interest or instrument commonly known as a 'security,' or any...guarantee of, or warrant or right...to purchase any of the foregoing."

In 1 Loss, Securities Regulation 469 (2nd ed. 1961) it is stated:

> "A call is a 'right to***purchase' a security within the literal language of the definition; but a put is a right to sell. At the same time both types of option are such an integral part of securities trading that it seems entirely reasonable to subsume them under the phrases 'investment contract' and 'interest or instrument commonly known as a '"security."'"

The Securities & Exchange Commission has consistently taken the position that call options are securities within the meaning of the Act. Dean Witter & Co., '71-'72 CCH Fed. Sec. L. Ref. ¶78,602 (Sec. 1971).

Options are securities under §3(a)(10) of the Securities Exchange Act of 1934, which defines the term "security" in substantially identical terms as §2(1) of the 1933 Acts. In Vogel-Lorber, Inc. v. Options On Shares, Inc., '74-'75 CCH Fed. Sec. L. Rep. ¶94,911 (SDNY 1974), the court expressly held that options which were being sold during the class period in the instant case were securities under the 1934 Act. In addition, the court upheld a claim for relief under the 1933 Act, thus implicitly holding that options are securities under both statutes.

The other common question in this case is whether the call options sold by defendants should have been registered under the Act.

It is plaintiff's contention that registration was required because of the large sales operation in which defendants were engaged. The options sold during the class period were sold in large numbers by a few brokers to a large class of purchasers. All call option contracts were alike except for the premium, the exercise price, the expiration date and the underlying stock. In such circumstances, registration is required. Dean Witter & Co., supra.

Today the listed options which are sold on five national securities exchanges are registered under the Act.

The only difference in listed options and the class period options is that listed options are standardized as to exercise prices and expiration dates.

The registration question affects every class member in exactly the same way. Should this court hold that registration was required, all the purchasers could recover. In addition, whether this action were to proceed as a class suit or an individual suit the registration question would turn on the same facts, viz., the method and size of option sales.

That registration was required for the options sold during the class period was affirmed by the SEC in Dean Witter & Co., supra, prior to the start of the class period. There a broker requested a no action letter in connection with the proposed sale of call options by one or more of its clients without registration under the Act. The staff reply stated, '71-'72 CCH Fed. Sec. L. Rep. at p. 81, 288:

> "The Commission has authorized me to advise you that it agrees with the position of the Division that call options may not be sold to the public without compliance with the registration requirements of the Act, absent an exception."

After resolution of the common questions in this case there are no individual questions. If this case

proceeds as a class action, a wrong done to 7,500 persons will be tried only once. In Green v. Wolf Corp., 106 F. 2d 291, 300 (2d Cir. 1968) cert. den. 395 U.S. 977, this Court said:

> "The very purpose to be served by a class action is the opportunity it affords to prevent a multiplicity of suits based on a wrong common to all."

The usefulness of the class action in securities fraud cases was set forth clearly in Escott v. Barchris Construction Corporation, 340 F.2d 731 (2d Cir. 1965), cert. den. 382 U.S. 816. In holding that the real issue in that case was certain to be the falsity of a registration statement, this court, 340 F.2d at 733, said:

> "The theoretical possibility of having to try that issue thirty-five hundred times... demonstrates the desirability of providing for a representative action in which the issue of falsity be tried only once. The Advisory Committee's note on the proposed amendment to Rule 23 suggested that the kind of situation we have here, 'a fraud perpetuated [perpetrated] on numerons by the use of similar misrepresentations, is an appealing situation for a class action.' The obvious desirability of avoiding multiplicity of actions turns us towards favoring the representative suit and encouraging its use.

B. The Class Is So Numerous that Joinder is Impracticable

Plaintiff has estimated that the number of persons who purchased call options from defendants during the class period is approximately 7,500. Defendants have not disputed this estimate. A class of this size is large enough to satisfy the numerosity requirement of Rule 23(a)(1). Korn v. Franchard Corp., supra.

Defendants have argued that the only class that plaintiff might represent in this case would be a class of persons who purchased call options on the same underlying stock. Concededly, if the class were to be so limited, the numerosity requirement would not be met.

However, the class should not be defined with such artificial constraint. Under Rule 23(b)(3), a class is defined as that group affected by common questions of law and fact. Whenever such a group exists, a class exists, irrespective of preconceived notions of what a class "ought" to contain. Plaintiff contends that all call options should have been registered. The claim here concerns the options themselves, not the underlying shares. See Vogel Lorber, Inc. v. Options On Shares, Inc., supra, '74-'75 CCH Fed. Sec. L. Rep. ¶ 97,109. That question is common to all

purchasers regardless of the underlying stock, the exercize price, the expiration date, or the premium. It makes as little sense to limit the class in accordance with the underlying stock as to limit it in accordance with any of the other variables.

C. Plaintiff's Claims Are Typical of Class Claims

Plaintiff's claims are typical of the class he seeks to represent. This requirement has been construed to mean that the class representative must not have interests antagonistic to or in conflict with class members. Cannon v. Texas Gulf Sulphur Company, 47 F.R.D. 60 (S.D.N.Y. 1969); Berland v. Mack, 48 F.R.D. 121, 127 (S.D.N.Y. 1969); Mersay v. First Republic Corporation of America, 43 F.R.D. 465, 468 (S.D.N.Y. 1968); Brandt v. Owens-Illinois, Inc., 62 F.R.D. 160, 165 (S.D.N.Y. 1974); Robertson v. National Basketball Ass'n., 389 F.Supp. 867, 898 (S.D.N.Y. 1975). The issues to be tried in this case are narrow and there are no conflicts between plaintiff's interests and those of class members.

The typicality requirement of Rule 23(a)(3) is not destroyed by plaintiff's representation of all purchasers of call options. Plaintiff claims that it was

size and method of defendants' sale of call options that made registration necessary. Rather the inclusion in the class of purchasers of all options enhances rather than destroys typicality.

D. Plaintiff Will Adequately Protect the Class Interests

The guidelines set by the courts in determining adewuacy of representation are (1) co-extensive interests, Eisen v. Carlisle & Jacquelin, 391 F.2d 555, 562-63 (2nd Cir. 1968) revsd. on other grounds, 417 U.S. 156 (1974) and (2) expectation of vigorous prosection. Cannon v. Texas Gulf Sulphur Co., 47 F.R.D. 60 (S.D.N.Y. 1969).

These criteria are easily met. Plaintiff and his counsel have vigorously pursued this action with an objective common to each and every member of the class.

E. A Class Action Is Superior to Other Methods of Adjudicating the Controversy

The predominance of common questions over individual ones in federal securities fraud cases makes them most appealing for class actions. Green v. Wolf Corporation, supra, 406 F.2d at 300; Escott v.

Barchris Construction Corp., supra, p. 733; Berland v. Mack, 48 F.R.D. 121, 127-28 (S.D.N.Y. 1969); Fidelis Corp. v. Litton Industries, Inc., 293 F. Supp. 164, 170 (S.D.N.Y. 1968); Fischer v. Kletz, 41 FRD 377,382 (S.D.N.Y.1966).

The relevant question in determining the superiority of the class action to other procedures is the number injured by defendants' transgressions. Green v. Wolf Corp., supra, at p. 301; Hohmann v. Packard Inst. Co., 399 F.2d 711, 715 (7th Cir. 1968).

The "guiding principle" enunciated by this court in Green v. Wolf Corp., supra, at p. 298, is most fitting here:

> "It cannot be denied that the resolution of the class action issue in suits of this type places an onerous burden on the trial court. But if there is to be an error made, let it be in favor and not against the maintenance of the class action, for it is always subject to modification should later developments during the course of the trial so require. Esplin v. Hirschi, 402 F.2d 94, 99 (10th Cir. 1968)."

CONCLUSION

This Court should reverse the order of the district court and remand this case to proceed as a class action on behalf of all persons who purchased

call options from defendants during the period November 29, 1971 to November 29, 1972.

Respectfully submitted,

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A. ARNOLD GERSHON,

Of Counsel

ADDENDUM

Rule 23 of the Federal
Rules of Civil Procedure

(a) Prerequisites to a Class Action. One or more members of a class may sue or be sued as representative parties on behalf of all only if (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class.

(b) Class Actions Maintainable. An action may be maintained as a class action if the prerequisites of subdivision (a) are satisfied, and in addition:

(1) the prosecution of separate actions by or against individual members of the class would create a risk of

(A) inconsistent or varying adjudications with respect to individual members of the class which would establish incompatible standards of conduct for the party opposing the class, or

(B) adjudications with respect to individual

members of the class which would as a practical matter be dispositive of the interests of the other members not parties to the adjudications or substantially impair or impede their ability to protect their interests; or

(2) the party opposing the class has acted or refused to act on grounds generally applicable to the class, thereby making appropriate final injunctive relief or corresponding declaratory relief with respect to the class as a whole; or

(3) the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy. The matters pertinent to the findings include: (A) the interest of members of the class in individually controlling the prosecution or defense of separate actions; (B) the extent and nature of any litigation concerning the controversy already commenced by or against members of the class; (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; (D) the difficulties likely to be encountered in the management of a class action.

(c) Determination by Order Whether Class Action to be Maintained; Notice; Judgment; Actions Conducted Partially as Class Actions.

(1) As soon as practicable after the commencement of an action brought as a class action, the court shall determine by order whether it is to be so maintained. An order under this subdivision may be conditional, and may be altered or amended before the decision on the merits.

(2) In any class action maintained under subdivision (b) (3), the court shall direct to the members of the class the best notice practicable under the circumstances, including individual notice to all members who can be identified through reasonable effort. The notice shall advise each member that (A) the court will exclude him from the class if he so requests by a specified date; (B) the judgment, whether favorable or not, will include all members who do not request exclusion; and (C) any member who does not request exclusion may,if he desires,enter an appearance through his counsel.

(3) The judgment in an action maintained as a class action under subdivision (b)(1) or (b) (2), whether or not favorable to the class, shall include and describe

those whom the court finds to be members of the class. The judgment in an action maintained as a class action under subdivision (b)(3), whether or not favorable to the class, shall include and specify or describe those to whom the notice provided in subdivision (c) (2) was directed, and who have not requested exclusion, and whom the court finds to be members of the class.

(4) When appropriate (A) an action may be brought or maintained as a class action with respect to particular issues, or (B) a class may be divided into subclasses and each subclass treated as a class, and the provisions of this rule shall then be construed and applied accordingly.

(d) Orders in Conduct of Actions. In the conduct of actions to which this rule applies, the court may make appropriate orders; (1) determining the course of proceedings or prescribing measures to prevent undue repetition or complication in the presentation of evidence or argument; (2) requiring, for the protection of the members of the class or otherwise for the fair conduct of the action, that notice be given in such manner as the court may direct to some or all of the members of any step in the action, or of the proposed

extent of the judgment, or of the opportunity of members to signify whether they consider the representation fair and adequate, to intervene and present claims or defenses, or otherwise to come into the action; (3) imposing conditions on the representative parties or on intervenors; (4) requiring that the pleadings be amended to eliminate therefrom allegations as to representation of absent persons, and that the action proceed accordingly; (5) dealing with similar procedural matters. The orders may be combined with an order under Rule 16, and may be altered or amended as may be desirable from time to time.

(e) Dismissal or Compromise. A class action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to all members of the class in such manner as the court directs.

RULE 11A - Civil Rules of the
United States District Court,
Southern District of New York

(c) Within sixty (60) days after the filing of a pleading asserting a claim for or against a class, the party asserting that claim shall move for a determination under Fed. R.Civ.P. 23(c) (1) as to whether the action is to be maintained as a class action and, if so, the membership of the class. In ruling upon such a motion, the court may allow the action to be so maintained, may disallow and strike the class action averments, or may order postponement of the determination pending discovery or such other preliminary procedures as appear to be appropriate and necessary in the circumstances. Whenever possible, where the determination is ordered to be postponed, a date will be fixed in the order for renewal of the motion before the same judge.

Securities Act of 1933
(15 U.S.C. Secs. 77a et seq.
Sec. 2(1)

The term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate of subscription, transferable share, investment contract, voting trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas or other mineral rights, or, in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

STATE OF NEW YORK)
: ss.:
COUNTY OF NEW YORK)

Bonnie Sprecherbeing duly sworn, deposes and says:

I am not a party to the action, am over the age of eighteen years, and reside at ~~xx~~ within City of New York

On December 23, , 1976, I served the within

Appellant's Brief and Appendix

upon each party therein named by mailing the same to said party or to his attorney at the address designated by him for that purpose, by depositing a true copy thereof in a postpaid properly addressed wrapper in an official depository under the exclusive care and custody of the United States Post Office Department within the State, as follows: Messrs. Brown,Wood,Fuller Caldwell & Ivey
One Liberty Plaza, New York, N.Y. 10006 and
Messrs. Lorber, Vogel & BErger, 111 East Avenue
Norwalk, Connecticut 06851

Bonnie Sprecher

Sworn to before me this
23 day of December, 1976

Mildred B. Honig
Notary Public

MILDRED B. HONIG
NOTARY PUBLIC, State of New York
No. 41-1850361 Queens County
Certificate filed in New York County
Term Expires March 30, 1977

STATE OF NEW YORK)
: SS.:
COUNTY OF NEW YORK)

Bonnie Sprecherbeing duly sworn, deposes and says:

I am not a party to the action, am over the age of eighteen years, and reside at xx within City of New York

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Bonnie Sprecher

Sworn to before me this
23 day of December , 1976

Notary Public

MILDRED B. HORNS
NOTARY PUBLIC, State of New York
Queens County
Certificate filed in New York County
Term Expires March 30, 1977